APPENDIX.

Internal Revenue Code, Section 41:

"The net income shall be computed upon the basis of the taxpayer's annual acounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *"

Internal Revenue Code, Section 112 (b) (6):

"(6) *Property Received by Corporation on Complete Liquidation of Another.* No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. * * *"

Internal Revenue Code, Section 23(s):

"In computing net income there shall be allowed as deductions:

(s) *Net Operating Loss Deduction.* For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under Section 122."

Internal Revenue Code, Section 122:

"(b) *Amount of Carry-Back and Carry-Over*— (1) *Net Operating Loss Carry-Back*— (A) *Loss for Taxable Year Beginning Before 1950.* If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net opera-

ting carry-back for each of the two preceding taxable years. * * *"

Internal Revenue Code, Section 188:

"If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner."

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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 261

STANDARD PAVING COMPANY, A DISSOLVED CORPORATION, APPEARING THROUGH I. V. GRAY, CHAS. GRAY, J. L. GRAY, J. B. GRAY, AND H. C. GRAY, ITS DIRECTORS AT THE TIME OF DISSOLUTION AND ITS LIQUIDATING TRUSTEES, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

STANDARD PAVING COMPANY, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 73-106) is reported at 13 T.C. 425. The opinion of the Court

of Appeals for the Tenth Circuit (R. 233-238) is reported at 190 F. 2d 330.

JURISDICTION

The judgments of the Court of Appeals were entered on June 26, 1951. (R. 238-239.) The petition for a writ of certiorari was filed on August 21, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

A taxpayer, which reported income on the completed contract method of accounting, transferred all of its assets to its parent in a tax-free liquidation just before it had completed work on three large construction contracts to which all of its activities had been directed during the tax period. The questions presented are:

1. Whether the Commissioner abused the discretion granted him by Section 41 of the Internal Revenue Code in determining that the completed contract method of reporting income did not "clearly reflect the income" and in modifying that method by considering the percentage of completion of each contract at the date of liquidation.

2. Whether taxpayer is entitled to a net operating loss deduction, under Sections 23 (s) and 122 of the Internal Revenue Code, representing the carryback of the net operating loss of its successor corporation for the latter's fiscal year ending September 30, 1943.

STATUTE AND REGULATIONS INVOLVED

These will be found in the Appendix, *infra*, pp. 17-20.

STATEMENT

The material facts found by the Tax Court (R. 74-85) may be summarized as follows:

The dissolved Standard Paving Company (hereinafter referred to as Oklahoma Standard) was an Oklahoma corporation, all of the stock of which was owned by Standard Paving Company, a Delaware corporation (hereinafter referred to as Delaware Standard).[1] The controversy here concerns the tax liability of Oklahoma Standard for the period January 1, 1942, through September 20, 1942. (R. 73-75.) Standard Paving Company (the Delaware corporation) is a party because of its conceded transferee liability for all taxes due from taxpayer. (R. 71-72; Pet. 2.)

Taxpayer followed the accrual basis of accounting, but reported income from long-term construction contracts on the completed contract basis. (R. 75.) On September 20, 1942, taxpayer was liquidated in a non-taxable reorganization by transfer of its assets, subject to its liabilities, to its parent, Delaware Standard, in exchange for its stock which was thereupon cancelled. On that date, taxpayer was engaged in performing three large

[1] Prior to Oklahoma Standard's dissolution, Delaware Standard's name was Standard Bond & Investment Company. (R. 74.)

construction contracts which Delaware Standard agreed to complete. (R. 78.) One such contract—as a member of the Gruber Joint Venture, consisting of Oklahoma Standard and other contractors,—was to build a portion of the Cookson Hills Cantonment. A second contract was being performed by taxpayer as a member of another joint venture to build a portion of an air field near Dalhart, Texas. The third incompleted contract was the Memorial Boulevard contract between taxpayer and the Oklahoma State Highway Commission for the construction of certain roads near Tulsa, Oklahoma. (R. 75-77.)

Based upon estimates of the amounts earned for work done under the contracts through September 20, 1942 (including amounts actually paid under the contracts), the percentage of completion of the Gruber, Memorial Boulevard and Dalhart contracts was 91.34, 98.67, and 76.66, respectively. (R. 83.)

Oklahoma Standard did not report any income from the Gruber Joint Venture in its last return.[2] In his deficiency determination, the Commissioner included in the gross income of Oklahoma Standard the entire net profit from the Gruber project on the ground that the project was completed as of September 20, 1942. (R. 80-81, 96.) The Com-

[2] The Gruber Joint Venture had received $2,157,893.88 prior to September 21, 1942, as partial payment for work actually performed, of which one third was allocable to the taxpayer. (R. 79.)

missioner conceded in the Tax Court, however, that the contract was only 91.34 percent completed on September 20, 1942, and that, accordingly, only that percentage of the net profit should be taxed to Oklahoma Standard. (R. 88, 96-97.)

As in the case of the Gruber income, taxpayer reported no income at all from the Dalhart project.[3] The Commissioner determined that the taxpayer had gross income of $95,255.07 from that project. He relied on the facts that the contract had been 95 percent completed on the liquidation date and that the total profit on the contract was estimated to be $100,268.50. In the deficiency notice, the Commissioner assigned, as his authority for the determination, Section 41 of the Internal Revenue Code. (R. 26-27, 82-83.)

Oklahoma Standard included $12,700.72 in gross income as profit from the Memorial Boulevard contract but in the Tax Court sought a determination of overassessment on the ground that none of this income should have been reported because the contract had not been completed on its liquidation date. (R. 83, 96.) On that date it had earned 98.67 percent of the contract price and it had received $81,249.37 as partial payment. (R. 83.)

The Commissioner's determination under Section 41, that Oklahoma Standard's method of reporting income on the completed contract method

[3] On September 20, 1942, Oklahoma Standard had received from the United States $256,735.16 as partial payment and had earned an additional $208,463.31. (R. 81.)

did not properly reflect income and that it was necessary to modify that method by attributing to Oklahoma Standard the same percentage of the total profit as the percentage of completion of the contract on the liquidation date, was sustained by the unanimous Tax Court with only those changes in the actual percentage of completion conceded by the Commissioner to be necessary on the basis of evidence. Similarly, the Tax Court refused to hold that Oklahoma Standard had erroneously reported income from the Memorial Boulevard contract, and reduced the amount of income slightly, on the basis of agreement that the contract was 98.67 percent complete, rather than 100 percent complete, as of the date of liquidation. (R. 85-106.) Accordingly, the Tax Court held that taxpayer realized income for the taxable period ending with its liquidation of $208,998.11 from the Gruber contracts, $90,293.19 from the Dalhart contract and $12,531.80 from the Memorial Boulevard contract. (R. 101.) The Court of Appeals affirmed. (R. 233-238.)

ARGUMENT

I

1. The decision of the Court of Appeals—affirming the unanimous Tax Court—that the Commissioner acted within his statutory authority in changing taxpayer's method of accounting for long-term contracts from the completed contract

to a percentage of completion basis [4] is correct, and there is no conflict of decisions. The statutory condition of any taxpayer's right to use a particular method of accounting for income tax purposes is that it "clearly reflect the income." Section 41, Internal Revenue Code (Appendix, *infra*, pp. 17-18). "If in the opinion of the Commissioner it does not * * * 'the computation shall be made upon such basis and in such manner' as will, in his opinion, do so." *Brown* v. *Helvering*, 291 U.S. 193, 203. See, also *Lucas* v. *American Code Co.*, 280 U.S. 445, 449; *Carver* v. *Commissioner*, 10 T.C. 171, affirmed *per curiam*, 173 F. 2d 29 (C.A. 6th); *William Hardy, Inc.* v. *Commissioner*, 82 F. 2d 249 (C.A. 2d); *Rouss* v. *Bowers*, 30 F. 2d 628 (C.A. 2d).

Even if viewed de novo, it is obvious that a method of accounting does not properly reflect income if it results in the income from a taxpayer's entire effort for the whole of the tax period escaping tax, and instead being taxed to another, by the device of taxpayer dissolving just before it would be required to account for that income. In any event, in light of the unanimous opinions of both courts below that the Commissioner acted well within the discretion delegated to him by the stat-

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[4] These are the two alternative methods (to the usual cash, accrual or installment bases) for returning income from long-term contracts made available at the option of the taxpayer by the Treasury Regulations. See Treasury Regulations 111, Section 29.42-4 (Appendix, *infra*, p. 20).

ute, there is no occasion for further consideration by this Court.

2. Counsel assigns nine separate reasons for granting the writ [5] (Pet. 10-13) and alleges conflict or "probable conflict" with no less than seventeen decisions of this and other courts. There is no merit in any of these assertions of conflict. In fact the decision in the case closest to the present one is entirely consistent with the decision below. *Jud Plumbing & Heating* v. *Commissioner,* 153 F. 2d 681 (C.A. 5th).

a. The principal reliance seems to be that because Oklahoma Standard was liquidated in a tax-free exchange under Section 112(b)(6) of the Code, Section 41 is not applicable. But Section 112(b)(6) (Appendix, *infra,* pp. 18-19), like the other Section 112 nonrecognition provisions, is by its own terms concerned solely with the nonrecognition of gain or loss from the sale or exchange of property and does not, either by its language or purpose, deal with the entirely different question here presented—that of accounting for income earned in the carrying out of taxpayer's business prior to the tax-free liquidation. Cf. *Commissioner* v. *Phipps,* 336 U. S. 410, 417.

Advance Aluminum Castings Corp. v. *Harrison,* 158 F. 2d 922 (C.A. 7th), is not only not in conflict as alleged (Pet. 10, Br. 17-18), but illustrates

[5] Eight of which appear to be concerned somehow with the first question presented by the petition.

counsel's basic misconception of the meaning of nonrecognition under Section 112(b). In that case, a subsidiary on the installment basis of reporting income under Section 44(a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, dissolved in a transaction also meeting the requirements of Section 112(b)(6). The Commissioner's action, however, quite unlike that here, was to tax the subsidiary on its *gain* on the disposition of the installment contracts at the time of its dissolution, the gain being there measured by the difference between the subsidiary's tax basis and fair market value.[6] The Commissioner did not attempt, as counsel inaccurately states (Br. 18) "to tax to Pattern a portion of the collections received by Castings after * * * the reorganization."

b. Similarly, *Iowa Bridge Co.* v. *Commissioner,* 39 F. 2d 777 (C.A. 8th), alleged to be in conflict (Pet. 10, Br. 18-19), raised no question of the Commissioner's action under Section 41. The only question decided by the court was the validity of the assignments of certain contracts, a question not presented here. As the court stated (p. 780), "The government concedes that if the transfer and assignment of these contracts to Carpenter were

[6] The reason for the Commissioner's position was that Section 112(b)(6) in his view immunized only the recipient from recognition of gain and not the dissolving corporation. This position was supported by the addition to Section 44(d), made by the Revenue Act of 1938, c. 289, 52 Stat. 447, expressly relieving the distributing corporation from tax if the distribution was a liquidation falling within Section 112(b)(6), but having only prospective operation.

valid, then the profits arising therefrom belong to him, and not to the Iowa Bridge Company."

c. The assertion that the decision below conflicts with *Commissioner* v. *First State Bank of Stratford,* 168 F. 2d 1004 (C.A. 5th), certiorari denied, 335 U.S. 867 (Pet. 10-11), and, apparently for good measure, with *Helvering* v. *Eubank,* 311 U.S. 122, and *Helvering* v. *Horst,* 311 U.S. 112 (Br. 19-20), has no basis in fact. No question of assignment of income, anticipatory or otherwise, is involved in the case at bar. Oklahoma Standard was taxed on income earned by it in accordance with the generally applicable percentage of completion method of accounting [7] and, for most part, actually received by it.[8] *Eubank* and *Horst,* as the court below noted, actually support the decision below since they held that income must be taxed to the one who earns it.

d. No conflict with *Swiren* v. *Commissioner,* 183 F. 2d 656 (C.A. 7th), certiorari denied, 340 U.S. 912, and *Rogers* v. *Commissioner,* 180 F. 2d 720 (C.A. 3d), exists as alleged. (Pet. 11, Br. 20-21.) The question in those cases, not involved here, was whether the proceeds of the sale of a partnership interest was ordinary income or capital gain; and

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[7] Treasury Regulations 111, Section 29.42-4(a) (Appendix, *infra,* p. 20).

[8] As the Court of Appeals noted (R. 234) Oklahoma Standard (or in the case of the Gruber Project, the Gruber Joint Venture) had received, prior to Oklahoma Standard's liquidation, $2,209,845.96, $256,735.16 and $81,249.37 for the Gruber, Dalhart and Memorial Boulevard projects, respectively.

the question here, whether the Commissioner was justified in changing taxpayer's method of accounting properly to reflect income, was not involved there. Oklahoma Standard's position at all times in the court below was that it realized no income during its final taxable period and no question has heretofore been raised that gain realized on the dissolution of the joint ventures was capital, rather than ordinary income.

e. Petitioner contends (Pet. 11, Br. 21-23), that Oklahoma Standard could not, as of September 20, 1942, be taxed on its share of the income from the Gruber and Dalhart joint ventures because the joint ventures were on a calendar year basis of accounting. But this contention is based on petitioner's disagreement with the Tax Court's and the Court of Appeals' view of Oklahoma law as being that the assignment of an interest in a joint venture dissolves the joint venture, thus permitting the members to be taxed as of the date of dissolution. See *Guaranty Trust Co. v. Commissioner*, 303 U.S. 493. There is, moreover, no question that the local law was properly applied. It is well settled in Oklahoma that the law of joint venture follows the law of partnership.[9] The law of partnership in Oklahoma is specific that the partnership is dis-

[9] *Taylor v. Brindley*, 164 F. 2d 235 (C.A. 10th); *Commercial Lbr. Co. v. Nelson*, 181 Okla. 122; *Twyford v. Sonken-Galamba Corp.*, 177 Okla. 486; *Dobbins v. Texas Co.*, 136 Okla. 40; *Perry v. Morrison*, 118 Okla. 212; *Boles v. Akers*, 116 Okla. 266; *O. K. Boiler & Welding Co. v. Minnetonka Lumber Co.*, 103 Okla. 226.

solved upon the transfer of a partnership interest to one not a partner.[10] *Ferguson* v. *Nagle,* 159 Okla. 219, and *Wertzberger* v. *McJunkin,* 171 Okla. 528, both alleged to be contra (Pet. 22), are not in point. Both involved "mining" partnerships or joint ventures. It has long been settled Oklahoma law that a mining partnership is *sui generis. Sturm* v. *Ulrich,* 10 F. 2d 9, 12 (C.A. 8th); *Ferguson* v. *Nagle, supra,* p. 221. Regardless, however, of the merits of the local law controversy, such questions present no occasion for review here. *Helvering* v. *Stuart,* 317 U.S. 154, 162-163.

f. The assertion (Pet. 11, 23-24) that Oklahoma Standard realized no income prior to the end of the accounting period of the joint ventures, is itself directly in conflict with this Court's decision in *Guaranty Trust Co.* v. *Commissioner, supra,* assuming, as held below, that the joint ventures were dissolved on the withdrawal of Oklahoma Standard. See, also, *Darcy* v. *Commissioner,* 66 F. 2d 581 (C.A. 2d); *Davison* v. *Commissioner,* 54 F. 2d 1077 (C.A. 2d). The allegation that *Shunk* v. *Commissioner,* 173 F. 2d 747 (C.A. 6th), is in conflict is not only not correct, but in view of this Court's decision in *Guaranty Trust Co.* v. *Commissioner, supra,* would not in any event support the petition.

g. There is no merit either in the contention

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[10] 54 Oklahoma Statutes (1941), Section 45.

(Pet. 11-12, 24-27) that the Tax Court used a different method of determining Oklahoma Standard's income than the Commissioner had used in his deficiency letter, thus assuming power vested by the statute only in the Commissioner. The changes made by the Tax Court in the actual computation of the income did not depart from the theory expressed in the Commissioner's ninety-day letter. They involved only a change in the percentages of completion conceded by the Commissioner to be necessary on the basis of the evidence and the substitution of the actual ultimate net profit for the Commissioner's estimate. As the Tax Court correctly stated (R. 97), "There was no abandonment by respondent before or during the hearing of his original position." The Tax Court continued (R. 97) that the Commissioner's concession on brief, "At most * * * is an admission * * * that the evidence is against him to a specified degree."[11] *Ross* v. *Commissioner,* 169 F. 2d 483 (C.A. 1st) (Pet. 12), is not relevant because no change of position by the Commissioner has occurred at any point in this controversy.

h. The contention (Pet. 12) that the decision below authorizes the inclusion in income of such

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[11] The Tax Court aptly noted (R. 97) that if the Commissioner's concession required by the evidence could be "stretched to the lengths urged by petitioners * * * respondent would be at all times compelled to urge affirmation of his entire deficiency or lose everything under an admission, after the evidence was in, that an error of judgment, however small, had been committed."

items as "retainage, liquidated damages and contract increases" which "as a matter of law are not then accruable" and is "probably in conflict" with decisions of this Court [12] and with decisions of other Courts of Appeals [13] is also without merit. Although it is true that under the cases relied upon the items in question may not have been income on the *accrual* method of accounting because Oklahoma Standard's right had not become fixed, neither the principal nor the cases have the slightest relevance here because no question of accrual is involved. The method originally chosen by the taxpayer—completed contract—and the method substituted by the Commissioner—percentage of completion—both cut across the usual cash, accrual and installment methods and substitute methods which have no necessary relationship to the principles of any of the other methods. It is, therefore, as clearly irrelevant here to say that certain of these items were not accruable on September 20, 1942, as it would be to say to a taxpayer on the accrual method that an item otherwise accruable had not yet been paid.

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[12] Counsel apparently has reference (Br. 28-29) to *Security Mills Co.* v. *Commissioner*, 321 U.S. 281, and *Spring City Co.* v. *Commissioner*, 292 U.S. 182; *North American Oil* v. *Burnet*, 286 U.S. 417; *Lucas* v. *American Code Co.*, 280 U.S. 445.

[13] *Keasbey & Mattison Co.* v. *United States*, 141 F. 2d 163 (C.A. 3d); *Clifton Mfg. Co.* v. *Commissioner*, 137 F. 2d 290, 293 (C.A. 4th); and *Commissioner* v. *Mnookin's Estate*, 184 F. 2d 89 (C.A. 8th).

II

The contention (Pet. 11-12, Br. 29-30) that Oklahoma Standard is entitled under Sections 23(s) and 122 (Appendix, *infra*, pp. 17, 19), to carry back to its final tax period the net operating loss of its successor and parent, Delaware Standard, is inconsistent with the reasoning of the cases holding that a successor corporation is not entitled to deduct the losses of a predecessor even although it has assumed the predecessor's liabilities. *New Colonial Co.* v. *Helvering*, 292 U.S. 435; *Jones* v. *Noble Drilling Co.*, 135 F. 2d 721, 724 (C.A. 10th); *Weber Flour Mills Co.* v. *Commissioner*, 82 F. 2d 764, 765 (C.A. 10th); *May Oil Burner Corp.* v. *Commissioner*, 71 F. 2d 644 (C.A. 4th); *Athol Mfg. Co.* v. *Commissioner*, 54 F. 2d 230 (C.A. 1st); *Shreveport Producing & Refining Co.* v. *Commissioner*, 71 F. 2d 972 (C.A. 5th), certiorari denied, 293 U.S. 616. It is at least equally clear that a dissolved predecessor may not deduct the successor's losses.

The assertion of conflict with *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573 (C.A. 2d) (Pet. 13, Br. 30), is not well founded. That decision was based squarely on the premise that the resulting corporation in a merger is the same taxpayer as the component corporation. Here there was no merger, but a transfer of its assets by Oklahoma Standard in exchange for its stock held by Delaware Standard and a formal dissolution of Okla-

homa Standard. (R. 74, 78.) Therefore the decision has no application here.

Counsel's emphasis on the fact that a tax-free exchange occurred as justifying Oklahoma Standard's right to Delaware Standard's net operating loss deduction is the same contention in different form discussed in Part I, *supra*. The irrelevancy of the tax-free exchange contention in this connection is, moreover, indicated by the fact that a tax-free reorganization occurred in *New Colonial Co.* v. *Helvering*, *supra*, as well as in other cases, *supra*, denying to the successor the right to take the predecessor's deduction.

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition should be denied.

Respectfully submitted,

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SEPTEMBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [As added by Sec. 211(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in

section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

* * * * *

(26 U.S.C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED

(a) [Amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 42.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(6) *Property Received by Corporation on Complete Liquidation of Another.*—No gain

or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 112.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

* * * * *

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * * *

(26 U.S.C. 1946 ed., Sec. 122.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> Sec. 29.42-4. *Long-Term Contracts.*—Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. * * * Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon either of the following bases:
>
> (a) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.
>
> (b) Gross income may be reported for the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method clearly reflects the net income. * * *

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